The Global Financial Crisis - Lessons from a Compassionate Approach

Amal Randhir Karunaratna

Abstract

The global financial crisis (GFC) sees its genesis through a series of events that resulted in an explosion of debt fuelled by ignorance of the complexity and the desire on the part of a few individuals to generate increasing profits with rising risk levels that were not understood within the context of increasing deregulation. The resultant fall-out has been asymmetrical, with those who were powerless to influence the process being made to pay the price for decision makers who were self-obsessed; the core mentality of the capitalist system. Is there a better way? This paper argues that Buddhist principles of all-encompassing compassion, rather than a focus on individualism, is a better recipe for a more harmonious and just society with happiness as an indicator of success than an economic one based on unfettered wild forces unleashed by an dispassionate capitalist system that is only concerned with "the market".

Key words: GFC, Compassion, Capitalism, Happy Planet Index, Inequality, Empathy, Social Networks, Overconsumption, Greed, Self-Interests.

Introduction

Financial crises of varying intensity seem to be part of the economic landscape. Despite the focus on each one in isolation, they march past a time-line with some regularity: 1837, 1873, 1893, 1907, 1929, 1989 and the late 1990s which was the Asian crisis. From the last one, estimates of the total credit losses, in the US at least, are in the region of $2.2 trillion! The most notable in the US was the great depression starting in the 1929 and the great recession starting in 2007.

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A Russian economist, Nikolai Kondretiev, predicted the presence of economic cycles which he classified as short and long duration (Kondratieff, 1979). The cycles, it appears, average around 50 years and range from approximately 40-60 years in duration (Van Ewijk, 1982). Kondratiev paid for his ideas with his life: he was given the death penalty for presenting theories that were considered critical of Joseph Stalin in 1938. Although the existence of neatly predictable cycles are not widely accepted by academic economists, there is a gathering group of adherents who accept and use these cycles to their advantage in making investment decisions.

Although each economic downturn has different circumstances, they do have common characteristics. Both of the last two downturns were preceded by large increases in income and wealth inequality and by sharp increases in debt compared with equity amongst lower and middle income households (Cheung, 2007). It is no coincidence that the approximate cycles correspond to the length of a human generation which is around 25 years, and is predicated on structural changes to society and economies through large shifts in innovations and technology that result in massive job losses, changes to lifestyles and new ways of doing things that have to be absorbed by a new generation as lessons from the previous one are lost to the one succeeding.

This paper reviews some of the recent literature on economic crises, the forces leading up to them and posits that the underlying reasons for such excesses and crashes have more to do with human propensity towards greed and selfishness. With this, the capitalist system assumes that loosening the regulatory system will provide incentives for wealth creation which will result in cascading benefits for all rather than a select few. This assumption appears to be tested and found seriously wanting and underlying much human misery starting with rising inequality, and considers an alternative approach using the teachings of the Buddha Gautama who provided an ethical and compassionate basis for the creation and management of wealth. Such a basis of wealth creation results in happiness at an individual and societal level. The Global Happiness Index is suggested as a possible manifestation of humane and compassionate outcomes from economic and financial policies with a compassionate basis.

Regulation – Deregulation and the NFA

The present GFC (Global Financial Crisis) has characteristics in common with all the previous crises. Following the financial crisis in the US in the 1930's there was general agreement that some form of regulation was needed to reign-in the lightly regulated "free market" system that operated in the US at the time. Reckless behaviour threatened political and economic stability. Hence, a regulatory regime was created to prevent the speculative excesses of the late 1920s that led to the failure of thousands of financial institutions. These included a system where commercial and investment banks were separated, new monitoring systems and a new institution to insure against loss by depositors and forcing financial institutions to make disclosures about information to the public and adequate funds to meet

their financial obligations. This system worked well until the 1970's and was described as the golden age of modern capitalism as tight regulation reduced bank failures and financial crises. This system was also accompanied by declining social inequality. In the 1970s and 1980s however, the spectre of rising inflation and developing economy debts and the US Savings and Loan crisis created strains on the system and financial institutions were increasingly successful at evading the regulatory system; and regulatory systems are "a problem for a modern capitalist system" (Crotty, 2008, p.8). The capitalist system has a strong incentive to weaken the regulatory system with the creation and reliance on new financial products to remain competitive in the market (Crotty, 2008).

Faced with a choice of re-regulation or relaxing regulations, free market ideology won the day and was the catch cry of the Thatcher and Reagan periods – seen as revolutions. So, now there was a highly deregulated market which was referred to as the 'New Financial Architecture' (NFA) and was founded on a belief that a globally integrated and lightly regulated financial system was 'efficient' and market forces would determine the true value of securities (e.g., shares) and other financial investments available to investors. These systems were based on economic theories held to be gospel at the time. Very few writers or thinkers questioned these assumptions, or if they did, their opinions were often derided. This new set of dynamics were integrated into giant financial conglomerates that were now 'too big to fail' (incidentally, the title of a movie about this subject). The regulators were now in a position where the system was so complex that many didn't have the appropriate information to monitor the risks or didn't react to the risk or those agencies that provided risk ratings such as Moodies and Standard and Poors did not reflect the market reality (Crotty, 2008). The ratings provided by the rating agencies are used as important information by investors when making investment decisions.

By the late 2000s, regulations had been progressively relaxed until they were practically non-existent and the system was now operating in a state of perfect calm, corporate profits were high and debts were building up. The deregulation also resulted in lax lending standards that had no relationship to real values of the so-called assets that were being financed and resulted in an unfounded belief and betting that housing prices would rise constantly (Crotty, 2008).

Despite the widespread belief in the system by those within the system, during the evolution of the NFA, from the 1980's the World Bank identified 117 banking crises between the early 1970s and the early 2000s and, each time, though the gains were made by private individuals and organizations, the public, through Central Bank intervention was responsible for their rescue. This means, private organisations and individuals who created the problems were rescued by the government and, therefore, the public – the very organisations whose "interference" these entities eschewed.

By the late 2000s debt levels arising from complex financial products had reached unsustainable levels and the size of the financial sector in the US had now grown

from 10% in the 1980s to 40% of total corporate profits by 2006 (Crotty, 2008). The financial sector had now reached glamour status and become a highly desirable career path for business graduates and just about anyone who sought employment in it!

While the party was on (during total deregulation) consumers purchased houses they could ill afford, fuelled by the availability of cheap credit fuelled by two state backed housing giants in the US, Fannie Mae and Freddie Mac, to lend more to poorer people. The share of mortgages to more risky borrowers increased from 4% of the total to 15% before the crisis and fuelled a housing bubble which blew up. This created the financial crisis brought on by the very same mortgages that were intended to help reduce the disadvantages created by the rise in inequality (Crotty, 2008).

Inequality – Creation of Suffering

The boom followed by the 2008 crash was fuelled by a massive growth in income inequality where the bargaining power of the top 5% income group increased their income to further concentrate their financial assets at the expense of lower income "workers", who constitute 95% of the population. In this explanation, middle and lower income earners financed their consumption when their incomes were stalling by gaining increasing access to debt, while the top group further consolidated their investments and increased their wealth, i.e., the wealthy increased their wealth, while the less well-off were further mired in debt (Kumhof & Rancière, 2010).

Incomes of the top group were further explained by so-called performance pay (bonuses) based on profits by massive staff lay-offs. These created short-term performance effects but long-term problems through a lack of firms' strategic capacity for long-term performance and unemployed workers who found it difficult to be re-hired, particularly if they had specific skills and were older.

The greed cycle, thus generated, went upwards to the senior executives. In 2006 Goldman Sachs paid out $16 billion for an average bonus of $650,000, which was unequally distributed to its 25,000 employees. Wall Street's top traders received bonuses of up to $50 million that year, and despite the disasters that were starting to cascade in the second half of 2007 the five largest investment banks - Merrill, Goldman Sachs, Morgan Stanley, Lehman Brothers and Bear Stearns - paid out $66 billion in "compensation" in 2007, including an estimated $40 billion in bonuses, and this was despite a decline in profits from the previous year (Crotty, 2008). Income inequality, particularly in the finance sector soared with an accompanying explosion in top incomes (*The Economist*, 2011). High incomes of executives included bonuses, stock awards, options and pension arrangements and often appeared to have no relationship to the performance of the banks, which was where some of the largest annual compensation packages were paid, which was greater than $10 million and believed

to have rewarded excessive risk taking, disconnected with the banks' capital levels. Executive pay levels also dwarfed the pay of normal workers with ratios such as 475 times that of an average worker in the US compared with 22 times in the UK, 15 times in France, 12 times in Germany and 11 times in Japan (Prosser, 2009).

One of the quickest ways to improve short-term firm performance is to slash jobs in the guise of improving efficiency which is rewarded by investors in the share market. A report cited by Msnc.com from the Institute of Policy Studies showed that of the 50 firms that laid off the most workers since the outset of the economic crisis in 2008, their CEOs were paid 42% more than other CEOs in large US firms, and each of these firms laid off at least 3,000 workers between November 2008 and April 2010. One of the stars in this class, Hewlett Packard CEO Mark Hurd, slashed 6,400 jobs in 2009 when his compensation was $24.2 million for that year. Interestingly, Hurd resigned suddenly after an investigation into a sexual harassment claim found that he had falsified expense reports related to meetings with a female contractor, and yet, his severance pay was believed to be more than $40 million (Jones, 2010). A risk taking mind-set and an interconnected network of service providers, mortgage brokers, investment bankers, rating agencies and insurance companies formed a pipeline of money generating fees for each other and it was literally raining fees. They were also involved in company mergers and acquisitions that reached a peak of $3.8 trillion in 2006, 11% greater than another banner year of 2000 (Crotty, 2008).

From the foregoing discussion, we can see the causes and the consequences of the global crisis. Deregulation as was cyclically forgotten (recall the forces underlying Kondratiev cycles) followed by massive inequality that followed.

Capitalism Versus Communism – Two Extremes

When communism collapsed with the symbolic fall of the Berlin Wall in 1989 and the disintegration of the former USSR through Perestroika, capitalist countries automatically accepted the default condition of free markets as the only one that was worthy of legitimacy for the future with its accompanying free markets and deregulation. Recent events have shown that this is just the opposite end of two extremes of communism versus free market capitalism.

In reality, the market, as Soros and other critics of free markets see it, is that both communism and capitalism rely on information and the pricing mechanism for stable systems to function. In a centrally planned system (communism), a few decision makers supposedly imbued with perfect knowledge in making decisions about physical quantities created massive distortions with an eventual abandonment in favour of a market mechanism. But, both systems are based on the assumption of perfect knowledge. One case assumes market equilibrium; the other finds expression in an unconditional prediction of future outcomes, and both theories originated in the 19th century when the limitations of knowledge were not recognised, and science reigned supreme (Soros, 1994).

In the case of the capitalist system, the markets, although apparently objective, is far from being unbiased. Soros has argued rather convincingly, and we have seen that this is the case with the repeated collapses, that there is no tendency towards equilibrium. In fact, he states, "It makes more sense to claim that markets tend towards excesses, which sooner or later become unsustainable, so that they are eventually corrected" (Soros, 1994, p. 317), but the consequences of these corrective mechanisms appear to be seriously mal-distributed. People at the lower end of the economic food chain seem to be affected far more severely with income reductions, cost increases and taxes that are imposed to pay for these by the public system than those at the top end, as we have witnessed with corporate excesses. As a result of the collapse, or as part of it, inequalities of wealth were created, and is increasing in many of the developed economies such as America, Germany, Britain, Sweden and also China and India. The latter are considered to be part of the BRIC group of emerging economies (*The Economist*, 2011). While there are contradictory studies that have made opposing findings about the effects of inequality, there is powerful evidence indicating high levels of inequality are associated with violent crime (Ching-Chi & Pugh, 1993), higher mortality and overall poorer health (Wilkinson & Pickett), all of which are symptoms of increasing social misery, or dhukka, as elucidated by the Buddha Gautama.

Happiness – A Societal and Individual Goal – A Middle Way

At the heart of the capitalist system are economic theories based on economic fundamentals which are centred round the notion of optimal allocation of scarce resources. This is supposed to accompany individuals making "rational" decisions about what they are prepared to sacrifice in order to gain something of value and respond to incentives. Governments can sometimes improve market outcomes but markets are a good way to organise economic activity (Mankiew, 1997). This addresses the problem of how to satisfy unlimited wants with limited resources with a sense of objectivity and dispassion. In this system, there is only the market. Human happiness, therefore, is predicated on activities relating to production and consumption with a series of activities that are recognised and measurable. Central to these concepts is the basis of human decision making which finds its origins in the ideas of Adam Smith in 1776 who describes the value of self-interest, which may be seen as a mechanism for the simultaneous fulfilment of one's own interests and the interests of others, although the former dominates over those of others (Wickramasinghe, 2006). Such ideas were developed and dominated in western societies such as England and were quickly adopted in other capitalist orientated economies such as the US, and happiness has been increasingly equated with the betterment of one's own condition which is based on accumulation of greater wealth. Under this system, a wealthier person is happier than one who has less accumulated wealth (Wickramasinghe, 2006).

In a phenomenon coined "Affluenza" (Hamilton & Denniss, 2005), quote the Psychotherapist Jesse H.O'Neill: "...In individuals, it takes the form of dysfunctional or unhealthy relationship with money, regardless of one's socio-economic level. It manifests

as behaviours resulting from a preoccupation with -or imbalance around- the money in our lives" (Hamilton & Denniss, 2005, p.7). This culture of consumption equated with happiness, manifested itself with statistics such as the number of Americans who said a second car was a necessity which had risen from 20 per cent in 1973 to 37 per cent by 1996, and the necessities in most Australian homes now are plasma-screen TVs, air conditioning, personal computers, second bathrooms, mobile phones and, increasingly, private health insurance and private schooling for children (Hamilton & Denniss, 2005).

And yet, these consumer-driven societies appear to be less happy when compared with less affluent societies. Much of this consumption was fuelled by credit and a poor management and understanding of cheap credit.

If one considers the relationship between GDP (Gross Domestic Product) and an Index of Happiness (the HPI, the Happy Planet Index), while there is a general positive relationship between wealthy countries and the level of social happiness, this is only up to a point. The nations with the highest HPI scores for 2009 are located in South America with the highest being Costa Rica followed by the Dominican Republic, and high on the list (ranked 17th) is Bhutan and Sri Lanka at 22nd, whereas the wealthier Singapore is ranked 49th and the USA at 114th (NEF, 2009). Recently, economists have started to measure happiness and found a paradox. While the capitalist system is good at turning luxuries into necessities where the masses have access to what elites once enjoyed (e.g., overseas travel, personal transport), people eventually come to take such things for granted and begin to consider these items as essentials for normal living. They are then stuck on a treadmill of addiction to the pleasures of a better standard of living and to greater materiality, which has created a paradox in wealthy countries. In affluent countries, despite their wealth and standard of living, from America to Japan, indices of well-being (overall happiness) have not improved (*The Economist, 2006)*.

Dhukka – The first noble truth, and a path to its resolution

Is there a possible explanation for this apparent dissatisfaction amidst so much material well being? The Buddha's explanation of the human condition of Dhukka as the first of the four noble truths, may provide us with some insights.

The addiction and accumulation of material wealth, while providing momentary satisfaction, makes one happy only for a short time. The temporary nature of such a condition inevitably leads to dissatisfaction which can only be momentarily eliminated by another, similar, experience which inevitably fades, leading to unending cycles of dissatisfaction-want fulfilment-dissatisfaction, suggesting the foundations of economic cycles.

In this process, there is confusion between pleasure and happiness and much of it is focused on individual pleasure which can be achieved by focusing on external

circumstances through material well-being. Interestingly, this focus on material well-being and self-absorption appears to be associated with greater disconnectivity with those around us in a real sense, but is replaced by "social networking" with the likes of Facebook, used by more than 400 million users, Twitter and MySpace where users spend around six hours a month (Von Grove, 2910) and yet, many people rarely talk to, or even know, their neighbours.

There is also the absurd phenomenon of office workers sitting adjacent to each other emailing, rather than talking to each other. In their book, *The Art of Happiness in a Troubled World*, His Holiness the Dalai Lama and Cutler (2009) discuss statistics that the percentage of individuals with no close friends or confidants is a staggering 25 per cent of the American population, and earlier studies reported that on average, people had only three close friends in 1985, and this figure had dropped by a third by 2005 to two (Dalai Lama & Cutler, 2009). It appears that all our material well-being of modern transportation, entertainment and work patterns have increasingly isolated us as individuals.

The happiness index

The Dalai Lama's prescription for happiness, then, starts with developing greater connectivity through the cultivation of empathy *Muditha* and a genuine wish that others achieve happiness and wish to overcome suffering and have an equal right to happiness. Such empathy allows us to connect with others based on a sense of common humanity with our shared characteristics as humans (Dalai Lama & Cutler, 2009). Such connectivity developed through shared culture and spirituality is the basis of building a "common wealth" of rich personal encounters. It is pointed out by Robert Putnam that communities that have tighter social networks have lower crime rates, lower mortality, less corruption, more effective government and less tax evasion (Dalai Lama & Cutler, 2009).

We focus here on our commonality rather than differences, which are based on our perceptions and prejudices which are imposed upon them. His Holiness says, "If you want others to be happy, practice compassion. If you want to be happy, practice compassion" (Dalai Lama & Cutler, 2009). Such a prescription for happiness goes against the economic principles of self-centred material gain as the foundation of happiness. The cultivation of empathy and developing awareness of cause and effect lead to the sharing of wealth with others who are not equally blessed. The Buddha in the *Rattapala Sutta* discoursed that ignorance underlies a tendency for wealthy people to restrain from acts of generosity, but Buddhist writings state that the protection of others is the protection of oneself and creates the benefits of mental satisfaction, cements the bonds of friendship and cultivates generosity through reducing *Tanha* craving (Wickramasinghe, 2006).

As an antidote to overconsumption and towards cultivating restraint, Buddhist writings describe happiness as a process where one enjoys and meaningfully uses

one's righteously earned wealth *Bhoga Sukha* through the adoption of household wealth management by apportioning income into four equal parts. These constitute using one part for consumption, investing two parts to generate income over time to generate economic security and one part to meet emergencies and manage earnings in such a way that one's expenses do not exceed income. In modern economies, while such advice sets up an ideal, reductions in income through taxes and mandatory payments may make it difficult to adhere to such an ideal but the spirit is, nonetheless, an exhortation towards responsible management and restraint which curbs *Tanha*, greed. This principle of personal wealth management encompasses the creation of one's own happiness in rightful ways by supporting family (partner, children), servants and workers, supporting friends and associates and taking an interest in their needs, protection of one's wealth from danger, giving what is due to kings and the gods and making offerings to religious mendicants and conduct meritorious deeds for one's mental well-being (Hewawitharana, 2006). Such principles are totally at odds with self-interest, and directs one's mind towards *Santutti*, contentment, and *Appicchata* (a simple life) through the use of wealth (Hewawitharana, 2006).

The foundation of such wealth management and sharing is through the cultivation of the four positive virtues of *Metta* (loving kindness), *Karuna* (universal compassion), *Muditha* (sympathetic joy) and *Upekkha* (balanced mind). These qualities, when fully developed, lead towards the states of spiritual perfection. Such qualities are likely to create conditions that favour protection of the environment, restraint in the use of resources and consideration of their finiteness, appropriate treatment and management of by-products from their use in the form of toxic emissions and their effects on other organisms. Such principles would also consider the interactivity of people and the consequences of decisions such as layoffs during economic downturns with compassion and kindness. German firms, for example, resisted firing workers during down-turns and reduced their hours instead and reaped the benefits of retaining their skills compared with US practices of firing workers which resulted in difficulties when needing to re-hire during upturns (*The Economist*, 2010).

So, are the ideas of Buddhist principles governing financial systems and economies utopian and unattainable? Consider the Happy Planet Index (HPI) discussed earlier. The key principles here are a response to governments' obsession with GDP and address the absurdities inherent in GDP where a forest denuded of trees which are milled or turned into woodchips for paper are considered products and, therefore, adding to productivity (the "P" in GDP) but the habitat destruction and erosion run-offs that destroy fishing grounds are considered "externalities" and not counted. The HPI attempts to identify elements of society that create widespread conditions for human happiness which encompass life-expectancy, satisfaction with life and a low ecological footprint (NEF, 2009). It could be argued that these principles are closer to the Buddhist principles discussed earlier.

In a paper entitled "Towards Buddhist Economics" (2001), Tideman states that the concept of Gross National Happiness in Bhutan (analogous to the HPI) is both an

excellent starting point and target, but further definitions and conceptual refinement are needed. Rather than jettison the principles of capitalism or communism, it may be more viable to think in terms of total regulation versus unrestrained competition, where both are harmful in extremes, but the failure of one does not justify a slavish assumption that the other is right. Soros (1994) believes that both should be treated as limits within which a balance needs to be struck – a middle way - as advocated by the Buddha, a mixed economy which uses the benefits of market forces and government and all actors in the economy, to reclaim responsibility for society and define economic objectives in human terms. Buddhist ideals could be achieved if development is considered in terms of education, health, preservation of culture and nature, inclusiveness, ethics, freedom and competition (Tideman, 2001).

Conclusions

The self-centred excesses and a supreme belief in the sanctity of individual choice which form the basis of right-wing politics within the capitalist system, witnessed by the policies espoused by the line-up of candidates for the Republican Party in the USA and Thatcherism in England, have accelerated environmental destruction, social dislocation and a degradation of the quality of life and increasing unhappiness.

Recent protests billed "Occupy Wall St" can be seen as an awakening within a hitherto self-centred population deluded into believing that that the American dream of fame and wealth was something open to everyone with sufficient hard work. This dream, it appears, is over. There may be a tacit acceptance that the chances of the so-called 99% becoming one of the 1% elite are close enough to being negligible. These protests call for another way.

The principles of restraint, empathy and compassion, as exhorted by Gautama the Buddha, may benefit from reservoirs of funds allocated for security and emergencies, may translate into environmental protection, the creation of greater social cohesion through developing closer communities, through the design of living spaces, and insurance against communities beset by unexpected challenges through catastrophes of weather or disease outbreaks which are increasingly prevalent. Such an approach requires a fundamental re-thinking of the structure of society, where happiness is derived from meaningful social relationships between networks of people rather than between people and their acquisitions. Such support structures may benefit from the availability of common funds in the form of government reserves, and in countries where wage and income earners are already beleaguered with taxes, what would be a source of such funds? One such possibility was proposed by the Nobel prize winning economist James Tobin (Besson, Downs, Durant and Roman, 2006), who proposed the levying of a small tax on foreign exchange transactions which have the advantage of reducing risky and speculative trading (Palley, 1999), and has been estimated to raise $100 billion a year or 5% of the total federal governments outlays (Pollin, Baker and Schaberg 2003).

While there has been a concerted focus on the negative aspects of Tobin Taxes, they can be designed to minimise market distortions and reduce market volatility by increasing the costs of short-term speculative trading. Various forms of such taxes are currently in use in 38 countries (Pollin, Baker and Schaberg 2003) but, ironically, not in the USA. Such taxes, appropriately designed, have the potential to create a funds base, to fund policies that have a greater social focus and reduce volatile speculative movement of funds, without the potential for value creation.

A focus on human values such as creation of the conditions for happiness can only become operational when they are incorporated into the constitutions, charters and mission statements of private institutions and governments and their organs the same way that corporate social responsibility has penetrated these same spaces. Perhaps, it has started with Prime Minister Cameron's Happiness Index. The practice of the Dhamma is only effective and real when compassion is the only basis of making decisions.

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